



STATE BOARD OF EQUALIZATION

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Executive Director

August 4, 2006

Dear Interested Party:

Enclosed is the *Initial Discussion Paper* regarding the proposal to amend the definition of “materials” in Regulation 1521, *Construction Contractors*, to include solar panels and photovoltaic cells that are installed as part of a solar energy system. Discussion regarding proposed amendments to Regulation 1521 is scheduled for the Board’s **December 12, 2006, Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 10:00 A.M. on August 22, 2006**, at the Board of Equalization; 450 N Street; Sacramento, California.

If you are unable to attend the meeting but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the August 22 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on August 22, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Ms. Lynn Whitaker at (916) 324-8483 or by e-mail at Lynn.Whitaker@boe.ca.gov prior to August 15, 2006. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing. In addition, please let Ms. Whitaker know if you wish to have future correspondence, including the second discussion paper and all attachments, sent to your e-mail address rather than to your mailing address.

Whether or not you are able to attend the above interested parties’ meeting, please keep in mind that the due date for interested parties to provide written responses to staff’s analysis is **September 5, 2006**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the “Business Taxes Committee” page on the Board’s Internet web site (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of Committee discussion or issue



papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Khabbaz, Supervisor, Business Taxes Committee Team at (916) 322-5271.

Sincerely,

Jeffrey L. McGuire
Chief, Tax Policy Division
Sales and Use Tax Department

JLM:llw

Enclosures

cc: (all with enclosures)
Honorable John Chiang, Chair
Honorable Claude Parrish, Vice Chairman
Ms. Betty T. Yee, Acting Member, First District (MIC 71)
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel (MIC 73)
Mr. Chris Schutz, Board Member's Office, Fourth District (MIC 72)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)
Ms. Mira Tonis, Board Member's Office, First District (via e-mail)
Mr. Steve Kamp, Board Member's Office, First District (MIC 71 and via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Ramon J. Hirsig (MIC 73)
Ms. Kristine Cazadd (MIC 83)
Ms. Randie L. Henry (MIC 43)
Mr. Robert Lambert (MIC 82)
Mr. Randy Ferris (MIC 82)
Mr. Robert Tucker (MIC 82)
Ms. Sharon Jarvis (MIC 82)
Ms. Janice Thurston (via e-mail)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (MIC 85)
Mr. Todd Gilman (MIC 70)
Mr. Kenneth Topper (via e-mail)
Mr. Dave Hayes (MIC 67)
Ms. Freda Orendt (via e-mail)
Ms. Sheila Waters (via e-mail)
Mr. Stephen Rudd (via e-mail)
Mr. Joseph Young (via e-mail)
Mr. Vic Anderson (MIC 44 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Ms. Lynn Whitaker (MIC 50)
Ms. Lynda Cardwell (MIC 50)

INITIAL DISCUSSION PAPER

Proposed revisions to Regulation 1521, *Construction Contractors*, regarding photovoltaic cells and solar panels

Issue

Should the definition of “materials” in Regulation 1521, *Construction Contractors*, be amended to include solar panels and photovoltaic cells that are furnished and installed as part of a solar energy system?

Background

In March 2006, Mr. Les Nelson, Executive Director of the California Solar Energy Industries Association filed a petition with the Board to amend subdivision (a)(4) and Appendix A of Regulation 1521 to provide that photovoltaic cells and solar panels are “materials” when furnished and installed pursuant to a construction contract.

The Board heard industry’s petition at the May 17, 2006, Board meeting and referred the issue to the Business Taxes Committee (BTC) to work with interested parties. Proposed revisions by industry to Regulation 1521 are attached as Exhibit 1 (see pages 1, 8-9). The text of the proposed revision to subdivision (a)(4) is as follows:

“Solar panels and photovoltaic cells are considered materials when furnished and installed in the performance of a construction contract and are incorporated, attached or otherwise affixed to realty. Solar panels and photovoltaic cells when part of a solar energy system are considered to be architecturally or functionally integrated into the realty. Solar panels and photovoltaic cells that are held in place by their own size, weight and mass, are deemed to be affixed to realty when it is the intent of the parties that the solar panels are a permanent addition to the realty. A solar energy system is defined as any solar collector or other solar energy device that provides for the collection and distribution, and where applicable the storage of solar energy.”

The full petition can be found on the Board’s website at [www.boe.ca.gov/meetings/pdf/ItemJ5\(051706\).pdf](http://www.boe.ca.gov/meetings/pdf/ItemJ5(051706).pdf). In addition to the petition to revise Regulation 1521, there is also proposed legislation regarding this issue.

Assembly Bill 2806 (Hancock)

AB 2806 (2005-2006 Session) would add section 6018.9 to the Revenue and Taxation Code to provide that solar panels and photovoltaic cells included as part of a solar energy system be considered materials when furnished and installed in the performance of a construction contract. On June 19, 2006, the bill was amended to specify that the provisions are declaratory of existing law.

In its analysis of this amendment, the Board’s staff disagreed that the provisions are entirely declaratory of existing law. Staff explained that while roofing tiles integrated with photovoltaic cells have been regarded as materials, other types of solar panels have generally been regarded as fixtures. Consequently, if the provisions of the bill were applied retroactively, construction

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contractors would be eligible to file claims for refund of any tax reported within the last three years on amounts in excess of the tax due on their cost of materials. Staff's analysis of AB 2806, including the June 19, 2006, amendment, can be found on the Board's website at www.boe.ca.gov/legdiv/sutleg/pdf/ab2806-2sw.pdf.

At this time, AB 2806 is being held in the Senate Committee on Revenue and Taxation. The committee may reconsider the bill when the Legislature reconvenes from summer recess on August 7, 2006.

The BTC is scheduled to discuss this issue at its meeting on December 12, 2006.

Discussion - construction contracts in general

Regulation 1521, which explains the Sales and Use Tax Law as it applies to construction contracts and construction contractors, makes a distinction between materials, fixtures, and machinery and equipment. "Materials" include construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, lose their identity and become an integral and inseparable part of the real property. Examples of materials include linoleum, concrete, bricks, doors, insulation, wallboard, windows, and roofing. In general, construction contractors are considered consumers of materials and tax applies to the sale of materials to the contractor or to the use of the materials by the contractor.

"Fixtures" include items that are accessory to a building or other structure and do not lose their identity as accessories when installed. Examples of fixtures include air conditioning units, burglar and fire alarms, heating units, prefabricated cabinets, lighting fixtures, electric generators, and plumbing fixtures. Except for construction contracts with the United States government, construction contractors are considered retailers of fixtures and tax applies to the contractor's separately stated selling price. If no selling price is stated in the contract, tax is due on the "cost price" of the fixture to the contractor. For fixtures acquired in a completed condition, "cost price" is deemed to be the contractor's purchase price. For contractors that self-manufacture the fixtures they install, "cost price" is defined as:

- The price at which a similar fixture is sold by the manufacturer/contractor to other contractors ready for installation, or
- If there are no similar fixtures, "cost price" is the amount stated in the records of the contractor, or
- If "cost price" cannot be established from the records, "cost price" is the total of material cost, direct labor, specific factory costs, excise tax, a pro-rata share of overhead, and a reasonable profit.

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Jobsite fabrication labor, such as the labor to assemble the fixture at the home or business prior to installation, must also be included in the “cost price” of the fixture.

Contractors are consumers of fixtures furnished and installed in the performance of a construction contract for the United States government.

“Machinery and equipment” is defined as property intended to be used in the production, manufacturing or processing of tangible personal property, or in the performance of services or for other purposes not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. Construction contractors are retailers of machinery and equipment.

Discussion - construction contracts involving solar energy systems

Photovoltaic (PV) cells are devices that produce electricity from sunlight. Groups of PV cells are laid side-by-side and encapsulated in a protective laminate to form a PV module. Modules are combined to create PV (solar) panels that are installed in solar energy systems. Solar energy systems may also have batteries, charge controllers, and inverters which convert the direct current generated by the PV system into an alternating current, the type of electricity required to run most electronic devices.

Solar panels furnished under construction contracts come in a variety of forms including:

- Frame-mounted glass panels. Often used in residential projects, these panels are attached to rooftops with metal brackets and rails.
- Roof tiles that are integrated with PV cells. These tiles blend in with normal roofing shingles. Some integrated tiles are not water tight and are installed over composition roofing shingles; other integrated tiles may replace normal roofing materials.
- Solar laminates that are affixed with a “peel & stick” adhesive. PV cells are encapsulated in high-light-transmissive polymer and may be used on slanted metal roofs.
- Interlocking roof tiles or modular panel systems that rest in place. Designed for flat roofs, these systems are installed without roof penetrations or attachments. Although other system components such as wiring and inverters may be bolted or otherwise affixed to the realty, the solar panels themselves are not attached to the roof.

Solar panels can be installed on commercial and residential buildings, or they can be used in free-standing structures such as those used in large-scale solar facilities in the desert. Free-standing structures can also be designed and erected as structures used to cover parking lots and serve a dual purpose as shade structures and solar energy systems.

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Currently, staff considers frame-mounted glass solar panels to be analogous to electric generators and regards these panels as fixtures since they are accessory to a structure and do not lose their identity as accessories when installed. Staff has also considered non-penetrating solar panels such as interlocking roof tiles or modular systems that rest in place to be fixtures. In contrast, PV integrated roof tiles have been considered materials since they lose their identity when affixed to become an integral and inseparable part of the real property. In addition, staff regarded panels used in free-standing shade structures in parking lots as materials. Since these panels function as a roof on a carport, staff considered the panels to lose their identity when installed.

The classification of a solar panel as a “material” or “fixture” is important when determining the amount subject to sales or use tax. As explained in the prior section, construction contractors are generally regarded as consumers of materials they purchase, and their tax liability is limited to tax reimbursement or use tax on their purchase price of materials furnished and installed in performance of the construction contract. In contrast, construction contractors are generally considered retailers of fixtures, and tax applies to the contractor’s sales of fixtures. Thus, construction contractors that self-manufacture solar panels that are considered “materials” are liable for tax on the cost of the materials used to fabricate the panel, but no tax is due on the cost of the labor or overhead expended in the creation of the panel. On the other hand, if the solar panel is considered a “fixture” and the contractor/manufacturer does not separately state a selling price for panels, tax is due based on the contractor’s “cost price.” As explained in the prior section, that “cost price” can include the contractor’s cost of materials, direct labor to fabricate the panels, related overhead, etc. See Exhibit 2 for a comparison of the contractor’s liability when panels are materials or fixtures.

Grounds for the Petition

The petitioner explains that it is requesting Regulation 1521 be amended to encourage regulatory clarity, equal treatment, and administrative efficiency. With regard to clarity, the petitioner believes that Regulation 1521 is not clear and specific as to how its provisions apply to solar materials and to solar contractors and integrators. Petitioner states there are no annotations¹ that provide specific guidance related to the solar energy industry. Petitioner believes the perceived lack of clarity creates ambiguity and confusion in terms of how solar contractors and integrators are to comply with Regulation 1521.

Petitioner explains that solar contractors have historically considered themselves construction contractors furnishing and installing building and construction materials. Based on this assertion, petitioner believes contractors are exposed to the risk of future liabilities if this interpretation differs from Board staff’s. Clarity in the regulation will provide both solar contractors and tax auditors with a firm basis on how the rules should be applied.

¹ Annotations published in the Business Taxes Law Guides are summaries of the conclusions reached in selected legal rulings of counsel. “Legal ruling of counsel” means a legal opinion written and signed by the Chief Counsel or an attorney who is the Chief Counsel’s designee, addressing a specific tax application inquiry from a taxpayer or taxpayer representative, a local government, or Board of Equalization staff.

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As a final point, the petition notes that the State of California recently passed the California Solar Initiative, the goal of which is to bring an additional 3,000 megawatts of photovoltaic power to the California market. With this planned growth in customer-sited solar energy, the petitioner believes it is critical to provide solar contractors with clear guidance as to the proper application of sales and use taxes.

Discussion - placement of proposed amendments

The petition suggests amending subdivision (a)(4) and Appendix A of Regulation 1521. Currently, subdivision (a)(4) includes a general definition of “materials” with a reference to Appendix A for a list of specific products. Guidelines for specific construction industries are provided in subdivision (c), Particular Applications. To maintain consistency in the organization of Regulation 1521, staff suggests that the petitioner move the amendments proposed in subdivision (a)(4) to subdivision (c).

Summary

Regulation 1521 provides guidance regarding the application of sales and use tax to construction contracts. Currently, the regulation does not specifically address how tax applies to contracts to furnish and install solar energy systems. Under discussion is a proposal to amend the definition of “materials” to include solar panels and photovoltaic cells that are installed as part of a solar energy system. Interested parties are welcome to submit comments or suggestions on this issue and are invited to participate in the interested parties meeting scheduled for August 22, 2006, in Sacramento.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 08/02/2006

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Regulation 1521. CONSTRUCTION CONTRACTORS.

Reference: Sections 6006-6010, 6012, 6012.2, 6012.6, 6012.8, 6012.9, 6015, 6016, 6016.3, 6016.5, 6055, 6091-6095, 6203.5, 6241-6246, 6276, 6276.1, 6379, 6384, 6386, 6421, 6901.5, Revenue and Taxation Code.

(a) DEFINITIONS.

(1) CONSTRUCTION CONTRACT.

(A) "Construction contract" means and includes a contract, whether on a lump sum, time and material, cost plus, or other basis, to:

1. Erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property, or
2. Erect, construct, alter, or repair any fixed works such as waterways and hydroelectric plants, steam and atomic electric generating plants, electrical transmission and distribution lines, telephone and telegraph lines, railroads, highways, airports, sewers and sewage disposal plants and systems, waterworks and water distribution systems, gas transmission and distribution systems, pipelines and other systems for the transmission of petroleum and other liquid or gaseous substances, refineries and chemical plants, or
3. Pave surfaces separately or in connection with any of the above works or projects, or
4. Furnish and install the property becoming a part of a central heating, air-conditioning, or electrical system of a building or other structure, and furnish and install wires, ducts, pipes, vents, and other conduit imbedded in or securely affixed to the land or a structure thereon.

(B) "Construction contract" does not include:

1. A contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or
2. The furnishing of tangible personal property under what is otherwise a construction contract if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of the property furnished.

(2) CONSTRUCTION CONTRACTOR. "Construction contractor" means any person who for himself or herself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. "Construction contractor" includes subcontractors and specialty contractors and those engaged in such building trades as carpentry, bricklaying, cement work, steel work, plastering, drywall installation, sheet metal work, roofing, tile and terrazzo work, electrical work, plumbing, heating, air-conditioning, elevator installation and construction, painting, and persons installing floor coverings, including linoleum, floor tile, and wall-to-wall carpeting, by permanently affixing such coverings to a floor. "Construction contractor" includes any person required to be licensed under the California Contractors' State License Law (Business & Professions Code Sections 7000 et seq.), and any person contracting with the United States to perform a construction contract, whether such persons are formed or organized under the laws of this state, or another state or country.

(3) UNITED STATES CONSTRUCTION CONTRACTOR. "United States construction contractor" means a construction contractor who for himself or herself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract for the United States Government.

(4) MATERIALS. "Materials" means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. A list of typical items regarded as materials is set forth in Appendix A.

Solar panels and photovoltaic cells are considered materials when furnished and installed in the performance of a construction contract and are incorporated, attached or otherwise affixed to realty. Solar panels and photovoltaic cells when part of a solar energy system are considered to be architecturally or functionally integrated into the realty. Solar panels and photovoltaic cells that are held in place by their own size, weight and mass, are deemed to be affixed to realty when it is the intent of the parties that the solar panels are a permanent addition to the realty. A solar energy system is defined as any solar collector or other solar energy device that provides for the collection and distribution, and where applicable the storage of solar energy.

(5) FIXTURES. "Fixtures" means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. A list of typical items regarded as fixtures is set forth in Appendix B.

(6) **MACHINERY AND EQUIPMENT.** "Machinery and equipment" means and includes property intended to be used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. "Machinery and equipment" does not include junction boxes, switches, conduit and wiring, or valves, pipes, and tubing incorporated into fixed works, buildings, or other structures, whether or not such items are used solely or partially in connection with the operation of machinery and equipment, nor does it include items of tangible personal property such as power shovels, cranes, trucks, and hand or power tools used to perform the construction contract. A list of typical items regarded as machinery and equipment together with a list of typical items not regarded as machinery and equipment is set forth in Appendix C.

(7) **TIME AND MATERIAL CONTRACT.** "Time and material contract" means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.

(8) **LUMP SUM CONTRACT.** "Lump sum contract" means a contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated in the invoice.

(b) APPLICATION OF TAX.

(1) UNITED STATES CONSTRUCTION CONTRACTORS.

(A) Materials and Fixtures. United States construction contractors are consumers of materials and fixtures which they furnish and install in the performance of contracts with the United States Government. Either the sales tax or the use tax applies with respect to sales of tangible personal property (including materials, fixtures, supplies, and equipment) to contractors for use in the performance of such contracts with the United States for the construction of improvements on or to real property in this state. The fact that the contract may provide principally for the manufacture or acquisition of tangible personal property is immaterial. The sales tax, but not the use tax, applies even though the contractor purchases the property as the agent of the United States.

(B) Machinery and Equipment. United States contractors are retailers of machinery and equipment furnished in connection with the performance of a construction contract with the United States Government. Tax does not apply to sales of machinery and equipment to United States contractors or subcontractors, provided title to the property passes to the United States before the contractor makes any use of it. Such sales are sales for resale, and the purchasing contractor may issue a resale certificate. A contractor who uses the machinery or equipment before title passes to the United States is the consumer of that machinery or equipment and either sales tax or use tax applies with respect to the sale to or the use by the contractor.

(2) CONSTRUCTION CONTRACTORS OTHER THAN UNITED STATES CONSTRUCTION CONTRACTORS.

(A) Materials.

1. In General. Construction contractors are consumers of materials which they furnish and install in the performance of construction contracts. Either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.

2. When Contractor is Seller. A construction contractor may contract to sell materials and also to install the materials sold. If the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge for installation, the contractor will be deemed to be the retailer of the materials.

In the case of a time and material contract, if the contractor bills his or her customer an amount for "sales tax" computed upon his or her marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that he or she is the retailer of the materials.

If the sale occurs in this state, the sales tax applies to the contractor's (retailer's) gross receipts from the sale of the materials. If the sale occurs prior to the time the property is brought into this state, the contractor's (retailer's) customer is the consumer and his or her use (unless otherwise exempt) is subject to use tax measured by the sales price. The contractor must collect the use tax and pay it to this state.

(B) Fixtures.

1. In General. Construction contractors are retailers of fixtures which they furnish and install in the performance of construction contracts and tax applies to their sales of the fixtures.

2. Measure of Tax.

a. In General. If the contract states the sale price at which the fixture is sold, tax applies to that price. If the contract does not state the sale price of the fixture, the sale price shall be deemed to be the cost price of the fixture to the contractor.

b. Determining Cost Price. If the contractor purchases the fixtures in a completed condition, the cost price is deemed to be the sale price of the fixture to him or her and shall include any manufacturer's excise tax or import duty imposed with respect to the fixture prior to its sale by the contractor.

If the contractor is the manufacturer of the fixture, the cost price is deemed to be the price at which similar fixtures in similar quantities ready for installation are sold by him or her to other contractors.

If similar fixtures are not sold to other contractors ready for installation, then the cost price shall be deemed to be the amount stated in the price lists, bid sheets or other records of the contractor.

If the sale price cannot be established in the above manner and the fixture is manufactured by the contractor, the cost price shall be deemed to be the aggregate of the following:

- [1] Cost of materials, including such items as freight-in and import duties,
- [2] Direct labor, including fringe benefits and payroll taxes,
- [3] Specific factory costs attributable to the fixture,
- [4] Any manufacturer's excise tax,
- [5] Pro rata share of all overhead attributable to the manufacture of the fixture, and

[6] Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors. Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture.

Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property.

3. Exceptions — Leased Fixtures. In some instances the construction contractor may furnish and install a fixture for a person, other than the owner of the realty, who intends to lease the fixture in place as tangible personal property as provided in Section 6016.3 of the Revenue and Taxation Code and pay tax measured by rental receipts.

In this case the construction contractor may take a resale certificate from the lessor at the time of the transaction and the sale to the lessor will be considered to be a sale for resale. The resale certificate should indicate that the fixture is purchased for resale by the purchaser as tangible personal property under Section 6016.3 of the Revenue and Taxation Code.

(C) Machinery and Equipment.

1. In General. Construction contractors are retailers of machinery and equipment even though the machinery and equipment is furnished in connection with a construction contract. Tax applies to the contractor's gross receipts from such sales.

2. Measure of Tax.

a. In General. Tax applies to the gross receipts from the sale of machinery and equipment furnished and installed by a construction contractor. If the contract calls only for the furnishing and installation of machinery and equipment, tax applies to the total contract price less those charges excludible from gross receipts under Section 6012 of the Revenue and Taxation Code.

b. Lump Sum Contracts — Determining Gross Receipts. If the contract is for a lump sum and includes the furnishing and installation of materials, fixtures, and machinery and equipment, the gross receipts from the sale of the machinery and equipment shall be the price at which similar quantities ready for installation are sold at retail delivered in the market area where the installation takes place.

If there is no such retail price for the machinery and equipment, then the gross receipts shall be determined from the contracts, price lists, bid sheets, or other records of the contractor.

If the gross receipts cannot be established in the above manner and the machinery and equipment is manufactured by the contractor, the gross receipts from the sale shall be the aggregate of the following:

- [1] Cost of materials, including such items as freight-in and import duties,
- [2] Direct labor, including fringe benefits and payroll taxes,
- [3] Specific factory costs attributable to the machinery or equipment,

[4] Any manufacturer's excise tax,

[5] Pro rata share of all overhead attributable to the machinery or equipment, including overhead attributable to manufacturing, selling, contracting, and administration, and

[6] Reasonable profit from the manufacture and sale of the machinery or equipment which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the machinery or equipment. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or the machinery or equipment to a structure or other real property.

(D) Cost Plus A Fee Contracts. When a contractor enters into a construction contract for a cost plus a fee or time and materials plus a fee, whether the fee is a lump sum or a percentage of costs, the fee is not included in the measure of tax. When the contractor is the manufacturer of the fixtures or machinery and equipment, the "cost price" of the fixtures and the gross receipts from the sale of the machinery and equipment shall be determined in accordance with (B) and (C) above.

(3) MISCELLANEOUS SALES BY CONTRACTORS. In addition to sales of fixtures and machinery and equipment, tax applies to all retail sales by contractors of tangible personal property, including parts, supplies, tools, construction equipment, buildings severed or to be severed by the contractor, and furniture, including furniture sold with a building, even though the building is sold "in place."

(4) PERMITS. Contractors engaged solely in performing construction contracts which do not involve the sale and installation of fixtures and who do not also engage in business as sellers or retailers are not required to hold seller's permits. However, if a contractor is a seller or retailer because he or she makes sales of fixtures, materials, or machinery and equipment, or other tangible personal property either in connection with or as part of a construction contract, or otherwise, he or she is required to hold a seller's permit.

(5) SUPPLIES AND TOOLS FOR SELF-USE. Contractors are the consumers of supplies such as oxygen, acetylene, gasoline, acid, thread-cutting oil, and tools and parts for tools, which they use in their business, and the tax applies to the sale of such supplies and tools to contractors.

(6) EXEMPTION CERTIFICATES.

(A) Resale Certificates. Contractors holding valid seller's permits may purchase fixtures and machinery and equipment for resale by issuing resale certificates to their suppliers. They may not purchase materials for resale unless they are also in the business of selling materials.

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him or her by taking a resale certificate from the prime contractor, interior decorators, designers, department stores, or others. However, under the circumstances described in subsection (b)(2)(B)3., a contractor may take a resale certificate for fixtures furnished and installed by him or her for a person other than the owner of the realty.

(B) Exemption Certificates for Out-of-State Use. Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller's permit when the property is used by the contractor outside this state in his or her performance of a contract to improve real property and as a result of such use the property is incorporated into and becomes a part of real property located outside this state. This exemption is available only if at the time of the purchase the contractor certifies in writing to the seller that he or she holds a valid California seller's permit (giving the number of that permit and identifying the property purchased) and states that the property will be used in the manner stated above. The certificate must be signed by the contractor or an authorized employee. Such a certification may appear in the body of a purchase order which bears the signature of the purchaser. Any certificate given subsequent to the time of purchase will not be recognized.

If the property purchased under a certificate is used by the contractor in any other manner or for any other purpose than stated in the certificate, the contractor shall be liable for sales tax as if he or she were a retailer making a retail sale of the property at the time of such use, and the sale price of the property to him or her shall be deemed the gross receipts from the sale.

(C) Deductions for Tax-Paid Purchases Resold. A contractor may claim a "tax-paid purchases resold" deduction for any property of which he or she is the retailer when he or she has reimbursed his or her vendor for tax which the vendor is required to pay to the State or has paid the use tax with respect to the property, and has resold the property prior to making any use of it. In the event that the contractor sells short ends or pieces which are not used other than in severing them from larger units purchased by him or her and as to which he or she has paid sales tax reimbursement or use tax, he or she may claim the deduction for tax-paid purchases resold, but the amount of the deduction shall not exceed the price at which he or she sells such short ends or pieces.

(c) PARTICULAR APPLICATIONS.

(1) **DRAPERIES AND DRAPERY HARDWARE.** Persons who contract to sell and install draperies including drapery hardware, such as brackets, rods, tracks, etc., are retailers of the items which they furnish and install.

Tax applies to the entire contract price exclusive of the charge for installation which charge should be separately stated. Installers who furnish drapery hardware or other tangible personal property may accept resale certificates from department stores or other sellers to furnish and install the draperies and drapery hardware.

The department stores or other sellers furnishing resale certificates are required to pay the tax to the state upon their selling price of the draperies and drapery hardware, exclusive of installation charges. The installer should segregate his or her installation charge in order that the department store or other seller may properly segregate its charge attributable to installation for purposes of determining its taxable gross receipts.

(2) **PREFABRICATED CABINETS.** A cabinet will be considered to be "prefabricated" and a "fixture" when 90 percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated.

(3) **PREFABRICATED BUILDINGS.** Prefabricated units such as commercial coaches, house trailers, etc., registered with the Department of Motor Vehicles or the Department of Housing and Community Development, are tangible personal property even though they may be connected to plumbing and utilities. A mobilehome which meets or is modified to meet, all applicable building codes and regulations and which is permanently affixed to realty, is an improvement to realty and is not personal property. A contract to furnish and install a prefabricated or modular building similar in size to, but which is not, a factory-built school building (relocatable classroom) is a construction contract whether the building rests in place by its own weight or is physically attached to realty. It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.

Generally, a contract to furnish and install a small prefabricated building, such as a shed or kiosk, which is movable as a unit from its site of installation, is a construction contract only if the building is required to be physically attached to real property by the seller, upon a concrete foundation or otherwise. The sale of such a unit to rest in place by its own weight, whether upon the ground, a concrete slab, or sills or piers, is not a construction contract even though the seller may deliver the unit to its site of use.

Prefabricated or modular buildings which are "factory-built housing" where permanently affixed to the realty are improvements to realty. The manufacturer of factory-built housing who contracts to furnish and install the factory-built housing manufactured by him or her is the consumer of the materials used in building and installing the factory-built housing and the retailer of the fixtures. Tax applies as provided in (b) above.

4) FACTOR-BUILT SCHOOL BUILDINGS.

(A) General. On and after September 26, 1989, a contract to furnish and install a factory-built school building is not a construction contract but rather is a sale of tangible personal property.

(B) Definitions.

1. "Factory-built School Building." The term "factory-built school building" (relocatable classroom) means and includes:

A. for the period September 26, 1989 through September 12, 1990, any building designed to be used as a school building as defined in Sections 39214 and 81165 of the Education Code and so used. A factory-built school building must be designed in compliance with state laws for school construction and approved by the structural safety section in the office of the State Architect. It must be wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a schoolsite.

B. effective September 13, 1990, any building which is designed or intended for use as a school building and is wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a site owned or leased by a school district or a community college district. A factory-built school building must be designed and manufactured in accordance with building standards adopted and approved pursuant to Chapter 4 (commencing with Section 18935) of Part 2.5 of Division 13 of the Health and Safety Code and must be approved by the structural safety section in the office of the State Architect.

The term does not include buildings licensed by either the Department of Motor Vehicles or the Department of Housing and Community Development. The term also does not include prefabricated or modular buildings which are similar in size to, but which are not, "factory-built school buildings". It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.

2. "Consumer."

A. For the period September 26, 1989 through September 12, 1990, the term "consumer" as used herein means either (1) a school or a school district or (2) a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school or school district to furnish and install such building.

B. Effective September 13, 1990, the term "consumer" as used herein means either (1) a school district or a community college district or (2) a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school district or a community college district to furnish and install such building.

(C) Place of Sale. The place of sale or purchase of a factory-built school building is the place of business of the retailer regardless of whether the sale of the building includes installation or whether the building is placed upon a permanent foundation.

(D) Application of Tax.

1. Tax applies to 40 percent of the sales price of the building to the consumer excluding any charge for placing the completed building on the site. The sales price of the building shall include amounts representing tangible personal property installed in the building by a subcontractor, whether prior to or after installation of the building at the site, provided such installation is called for in the prime contract for the building.

A separate contract to furnish and install tangible personal property in a factory-built school building after installation of the building at the site is a construction contract and tax applies as in (b) above. Any contract or subcontract for site preparation (e.g., foundation) is a construction contract and tax applies as in (b) above.

2. The sale of a factory-built school building to a purchaser who will resell the building without installation is a sale for resale and the seller may accept a resale certificate from the purchaser. If the purchaser then sells to a contractor who has an existing contract to install the building on a school site, tax will apply as in (c)(4)(D)1. above. If tax has been paid on the purchase price of a factory-built school building which is subsequently resold for installation, a tax-paid purchases resold deduction may be taken as provided in Regulation 1701 (18 CCR 1701).

(E) Exclusion Certificate. For the period September 26, 1989, through September 12, 1990, if the purchaser certifies in writing to the retailer that the factory built school building purchased will be consumed in a manner or for a purpose entitling the retailer to exclude 60% of the gross receipts or sales price from the measure of tax and uses the property in some other manner or for some other purpose, the purchaser shall be liable for payment of tax measured by 60% of the sales price. For the above stated period, all retailers who make retail sales of "factory-built school buildings" claimed to be subject to tax measured by 40 percent of the sales price must obtain from the "consumer" a signed certificate substantially in the form set forth below.

**CLAIM FOR 60% EXCLUSION FROM TAX ON
PURCHASE OF FACTORY-BUILT SCHOOL BUILDINGS**
(Sec. 6012.6, Rev. & Tax. Code)

I hereby certify that the factory-built school building that I

(Name of Purchaser-Consumer)

am purchasing under the authority of this certificate from

(Name of Retailer)

will be used as a school building as defined in Sales and Use Tax Regulation 1521. My seller's permit number, if any, is _____.

I further certify that I understand and agree that if the property purchased under the authority of this certificate is used by the purchaser for any purpose other than indicated above, the purchaser shall be liable for payment of tax to the State Board of Equalization at the time of such use measured by 60% of the sales price of the factory-built school building.

Signed by _____
(Name of Purchaser)

As: _____
(Owner, Partner, Purchasing Agent, etc.)

Date _____

(5) MOBILEHOMES INSTALLED FOR OCCUPANCY AS RESIDENCES. Operative July 1, 1980, a special measure of sales or use tax is provided for a mobilehome sold to be affixed to realty for occupancy as a residence. A mobilehome dealer who sells a new mobilehome to a construction contractor to be affixed to land for occupancy as a residence is the "retailer-consumer" of the property and is required to pay tax for the period in which the sale was made by the dealer measured by an amount equal to 75 percent of the retailer-consumer's purchase price of the mobilehome.

A construction contractor who withdraws a new mobilehome from an inventory purchased for resale to be affixed to realty for occupancy as a residence in the performance of a construction contract is required to pay tax measured by 75 percent of the purchase price by his or her mobilehome vendor except where the purchase is made directly from a mobilehome manufacturer. In the absence of satisfactory evidence of the vendor's purchase price it shall be presumed that the measure of tax for the transaction is an amount equivalent to 60 percent of the sales price of the mobilehome to the construction contractor.

A mobilehome manufacturer who sells a new mobilehome directly to a construction contractor for installation to real property for occupancy as a residence is required to pay tax measured by 75 percent of the sales price at which a similar mobilehome ready for installation would be sold by the manufacturer to a retailer-consumer in this state. A construction contractor who withdraws a new mobilehome from an inventory purchased from a manufacturer for resale must pay tax measured by 75 percent of his or her purchase price.

A mobilehome manufacturer who performs a construction contract by permanently affixing a new mobilehome to real property is the consumer of the material and the retailer of fixtures installed by him or her and the tax applies as set forth in paragraph (b) above.

Reference should also be made to the provisions of Regulation 1610.2 for additional interpretative rules relating to custom additions to the mobilehome prior to sale, transfers of nonvehicle items, and the application of the tax to a purchase made from an out-of-state retailer.

(6) REPAIR CONTRACTS. A contract to repair a fixture in place or a fixture the contractor is required by the contract to reaffix to the realty is a construction contract. Sales or use tax applies to the gross receipts or sales price of the parts sold by a contractor who is a retailer under this provision. Either sales tax or use tax applies to the sales price of the parts sold to or used by a contractor who is a consumer under this provision.

(A) United States Construction Contractors. A United States construction contractor is the consumer of the parts furnished in the performance of a construction contract to repair a fixture.

(B) Construction Contractors Other Than United States Construction Contractors.

1. A contractor is the retailer of the parts furnished in the performance of a construction contract to repair a fixture when the sale price of the parts is billed separately from the repair labor.

2. A contractor is the consumer of the parts furnished in the performance of a lump sum construction contract to repair a fixture.

(7) ELEVATOR INSTALLATIONS. A large number of components are included in the installation of an elevator system. Those portions constituting the cage or platform and its hoisting machinery are fixtures. The balance of the installation, if attached to a structure or other real property will generally be "materials."

Similarly, installation of escalators and moving sidewalks are in part fixtures and in part materials.

Following are examples of components constituting part of the cage or platform and its hoisting machinery, and which are fixtures:

alarm bell	door operator on cab or car	power units and control boxes
cab or car	door safety edge on cab	pumps
car doors	door sills on cab	pushbuttons on cab
car platform and sling	electronic door protector	wire and piping (which are
door hanger on cab	jack assembly	components of a fixture)
door openers	motors	

Following are examples of components constituting "materials" when attached to realty:

car guides	hoistway door sills and	sound insulating panels on
casing section of jack	jams	"materials"
assembly	hoistway door supports	structural steel (unless part of
guide rails	hoistway entrance	cab, car, or other "fixture")
hoistway doors	pushbuttons on hoistway	valve strainer
hoistway door frames	rail buckets	wire and piping attached to
hoistway door safety edge	sill, struts	"materials"

Following are examples of components constituting parts of escalators or moving sidewalks which are fixtures:

staircase	chains	other operating mechanisms
moving sidewalk	sprockets	
moving handrails	motors	

(8) TELEPHONE SWITCHBOARDS AND INSTRUMENTS. Telephone switching equipment installed in a building specifically designed to accommodate the equipment or attached to a building or structure in a manner such that its removal would cause damage to the equipment or building in which it is installed will be considered to be "fixtures" under paragraph (a)(5) of this regulation.

Telephone handsets, modular switching equipment and standardized, off-shelf, general purpose switching equipment sold for use in general purpose office buildings constitute machinery and equipment under paragraph (a)(6) of this regulation. Handsets, modular switching equipment and standardized equipment were previously classified as fixtures.

This change in classification shall be applied prospectively only with respect to construction contracts entered into on and after July 1, 1988, by contractors other than United States construction contractors.

(9) DEEP-WELL AGRICULTURAL PUMPS. A deep-well agricultural pump is tangible personal property if installed so that it rests in position by force of gravity and is not otherwise affixed to the land.

The pump is a fixture if:

- (A) It is affixed to the land such as by concrete, bolts or screws,
- (B) It is physically connected to an irrigation system such as by pipes or couplings so as to become an integral part of the system, or
- (C) It is enclosed by a pump house or other building or structure.

(10) REMOTE CONTROL GARAGE DOOR OPENERS. Remote control garage door opening units are fixtures. Portable transmitter units furnished pursuant to a construction contract are deemed to be fixtures and are taxable as provided in subdivision (b)(2)(B). Sales of portable transmitter units not a part of a construction contract, as, for example, sales of replacement units, are retail sales of tangible personal property and subject to tax as such.

(11) EXCESS REIMBURSEMENT. The excess tax reimbursement provisions of Regulation 1700 apply to construction contractors.

(12) ON-PREMISE ELECTRIC SIGNS.

(A) An on-premise electric sign is any electrically powered or illuminated structure, housing, sign, device, figure, statuary, painting, display, message, placard, or other contrivance or any part thereof affixed to real property and intended or used to advertise, or to provide data or information in the nature of advertising, for any of the following purposes: 1) To designate, identify, or indicate the name or business of the owner or occupant of the premises upon which the advertising display is located, or 2) To advertise the business conducted, services available or rendered, or the goods produced, sold, or available for sale, upon the property where the advertising display has been erected.

(B) APPLICATION OF TAX. An on-premise electric sign is a fixture and tax applies to the sale price of the sign. Notwithstanding the provisions of 1521(b)(2)(B), operative October 1, 2000, if the contract does not state the sale price of the sign, tax applies to 33 percent of the contract price of on-premise electric signs that are furnished and installed by the seller. "Contract price" includes charges for materials, fabrication labor, installation labor, overhead, profit, and other charges associated with the sale and installation of the sign. If a contract provides that a contractor is to install an on-premise electric sign furnished by a third party, the charges for installation are not taxable. If a seller furnishes but does not install an on-premise electric sign, the seller is a retailer of the sign and tax applies to the total contract price.

Separately stated charges for transportation are subject to tax as defined in Regulation 1628, Transportation Charges.

Appendix A. The following is a list of typical items regarded as materials:

Asphalt	Linoleum	Sand
Bricks	Lumber	Sheetmetal
Builders' hardware	Macadam	<u>Solar Panel</u>
Caulking material	Millwork	Steel
Cement	Mortar	Stone
Conduit	Oil	Stucco
Doors	Paint	Tile

Ducts	Paper	Wall coping
Electric wiring and connections	<u>Photovoltaic Cell</u>	Wallboard
Flooring	Piping, valves, and pipe fittings	Wallpaper
Glass	Plaster	Wall-to-wall carpeting (when affixed to the floor)
Gravel	Power poles, towers, and lines	Weather stripping
Insulation	Putty	Windows
Lath	Reinforcing mesh	Window screens
Lead	Roofing	Wire netting and screen
Lime		Wood preserver

Appendix B. The following is a list of typical items regarded as fixtures:

Air conditioning units	Furnaces, boilers, and heating units
Awnings	Lighting fixtures
Burglar alarm and fire alarm fixtures	Plumbing fixtures
Cabinets, counters, and lockers (prefabricated)	Refrigeration units
Cranes (including moving parts of cranes) affixed or annexed to a building, structure or fixed work) ¹	Signs
Electric generators (affixed to and accessory to a building, structure or fixed works)	Television antennas
Elevators, hoists, and conveying units	Transformers and switchgear
	Vault doors and equipment
	Venetian blinds

Appendix C. The following are lists of typical items regarded as:

<i>Machinery and Equipment</i>	<i>Not Machinery or Equipment</i>
Drill presses	Fixtures and materials as defined in this regulation
Electric generators (unaffixed, or, if affixed, which meet the requirements of subparagraph (a)(6))	Wiring, piping, etc., used as a source of power, water, etc., for machinery and equipment
Lathes	Radio transmission antennas
Machine tools	Large tanks (i.e., over 500 barrel capacity)
Printing presses	Fire alarm systems
	Street light standards
	Cooling towers other than small prefabricated cooling units

¹ Moving parts of cranes are classified as machinery and equipment when furnished and installed pursuant to fixed price construction contracts entered into prior to July 1, 1985.

The table below shows the difference in a construction contractor's liability for sales or use tax when solar panels are considered "materials" versus "fixtures." The table assumes that panels and panel components are purchased ex-tax and furnished and installed under a lump-sum construction contract (staff's understanding is that construction contracts to furnish and install solar energy systems are generally lump-sum contracts).

Classification of Solar Panel	How Acquired	Contractor Is Responsible for Reporting Tax on the:
MATERIALS	Panels are purchased in a completed condition	Cost of panels
	Panels are self-manufactured by installing contractor	Cost of components used to manufacture panels
FIXTURES	Panels are purchased in a completed condition	Cost of panels
	Panels are self-manufactured by installing contractor	<ol style="list-style-type: none"> 1. Price at which similar panels are sold by the manufacturer/contractor to other contractors ready for installation, or 2. If there are no similar fixtures, the amount stated in contractor's records (e.g., price lists or bid sheets), or 3. If price cannot be established from either (1) or (2), the total of: <ul style="list-style-type: none"> ○ The cost of the components used to manufacture the panels ○ Direct labor ○ Specific factory costs ○ Excise tax ○ A pro-rata share of overhead ○ A reasonable profit